Housing Bonds and Tax Reform: The Perils of a Partial Analysis of Low-Income Housing Programs

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While most persons in the United States live in housing that reflects America's prosperity and high quality of life by global standards, the plight of the nation's growing number of low- and moderate-income households has worsened during the 1980s. A 1988 report by the Joint Center for Housing Studies of Harvard University on the state of housing in America today depicted a distressing picture of the housing prospects for the nation's less well-to-do and portended an affordable housing crisis.[1] Regrettably, the the Tax Reform Act of 1986[2] has only worsened this crisis by failing to consider the legislation's deleterious effects on low- and moderate-income families and individuals hoping to find decent and affordable housing.

The issue of housing in America encompasses values and politics far beyond the mere provision of shelter from the inclement elements. Owning a home is both a fundamental ingredient and a yardstick of the "American Dream." Since the 1930s, the federal government has based its low-income housing policy upon the need

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1. Apgar & Brown, Joint Center for Housing Studies of Harv. Univ., The State of the Nation's Housing (1988) [hereinafter Harvard Study]. This report concluded that: first, the after-tax cost of homeownership is at historically high rates; second, the homeownership rate, particularly among young households, has declined steadily since 1980; third, inflation-adjusted rents now stand at the highest level of the past two decades; fourth, the nation's stock of low-income rental housing continues to shrink; fifth, for the growing number of low-income families, rents have surged dramatically as a proportion of income; and sixth, the burden of spiraling rental payments has been a major factor in the rise in the nation's homeless.

2. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (codified as I.R.C. (1986)) [hereinafter Tax Reform Act].

to provide a "*decent* home and a *suitable* living environment for every American family."[3] The Reagan Administration reaffirmed this goal when the President's Commission on Housing declared that "housing is a fundamental element of a strong State economy and a basic social need. When housing costs become too high and the housing recession occurs, there [are] widespread economic and social hardships."[4]

In pursuit of decent and affordable housing for all, Congress has implemented a variety of programs involving both direct and indirect housing subsidies.[5] One such program uses tax-exempt bond financing to stimulate indirectly both the construction of multi-family rental housing[6] for various "needy" groups—such as veterans, the elderly, and low- and moderate-income families[7]—and the provision of below market rate mortgage loans[8] for low- and moderate-income home buyers.[9]

3. Housing Act of 1949, Pub. L. No. 81-171, 63 Stat. 413 (1950) (emphasis added).

4. President's Commission on Housing, Report 3 (1982).

5. *See, e.g.*, United States Housing Act of 1937, Pub. L. No. 75-896, 50 Stat. 888 (codified at 42 U.S.C. §§ 1401-1430 (1973)) (providing direct subsidies to local housing authorities to stimulate clearance of slum areas for new housing construction); Housing Act of 1954, 68 Stat. 590, ch. 649 (codified at 42 U.S.C. § 1450 (1976)) (allocating additional monies for slum clearance and requiring localities to prepare master plans addressing local housing problems prior to receiving federal housing assistance); Housing and Urban Development Act of 1965, Pub. L. No. 89-117, 79 Stat. 451 (codified in scattered sections of 42 U.S.C.) (initiating rent-supplement program and authorizing local housing agencies to subsidize rents in existing housing); Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (codified as amended at 42 U.S.C. §§ 5303, 5305, 5307, 5316 (1976)) (replacement of categorical urban renewal programs with unified federal community development block grant program).

6. Qualified residential rental projects, as defined under IRS regulations, are buildings or structures, together with any functionally related and subordinate facilities such as parking for residents, that contain one or more similarly constructed units not used on a transient basis. Treas. Reg. § 1.103-8(b)(8) (1987). A project may consist of detached housing, row houses, high-rises, or other buildings with one or more dwelling units, or the residential portion of a mixed-use project. Treas. Reg. § 1.103-8(b)(8)(iv) (1982).

7. I.R.C. §§ 142(a)(7) and 142(d) (1987). *See also* I.R.C. § 103(b)(4)(A) (1968), Mortgage Subsidy Bond Tax Act of 1980, Pub. L. No. 96-499, 94 Stat. 2660 (codified at I.R.C. § 1 *et seq.* (1982 & Supp. III 1985)). *See generally* Fernsler, Tax-Exempt Financing for Housing and Community Development: A Year of Activity, 13 Urb. Law. 706 (1981); Pollak, Multi-Family Tax Exempt Revenue Bonds: The Policy-Making Role of Regulation, 15 Urb. Law. 577 (1983); Note, Multi-Family Housing Bonds: Can The Tax Code Provide an Efficient and Effective Lower-Income Housing Program?, 5 Va. Tax Rev. 497, 498-502 (1986).

8. Mortgage revenue bonds are sold in order to fund mortgages made to qualified borrowers to finance the purchase, improvement, or rehabilitation of either owner-occupied single family homes, condominium, or cooperative units or two- to four-family properties that the borrower will use as his principal residence. Temp. Treas. Reg. §§ 6a.103A-1(b)(6), 6a.103A-2(d).

9. I.R.C. § 143 (1986). The Mortgage Subsidy Bond Tax Act of 1980 radically changed the manner in which tax-exempt financing could be used to provide mortgages

Indirect subsidies for affordable housing through the issuance of tax-exempt bonds, however, have been subject to considerable criticism and legislative review.[10] During the past few years, Treasury officials and other commentators have charged that tax-exempt bonds are a highly inefficient means of subsidizing the nation's stock of affordable housing; they have contended that the government has lost more in forgone revenue than low- and moderate-income families have gained in housing income supplements.[11] Moreover, the efficacy of these bond-financed programs has been questioned on the ground that they have only assisted middle-income families, who could afford to rent or buy in the conventional housing market, in moving up to better housing.[12]

Although most of the tax reforms of the early 1980s targeted tax-exempt housing bond proceeds more toward low- and moderate-income individuals and families, the Tax Reform Act was a major legislative assault upon the ability to obtain tax-exempt financing for low- and moderate-income housing. The Act has severely curtailed the development of subsidized multi-family rental housing for low- and moderate-income families and, unless amended, will abolish tax-exempt bond financed mortgage purchase programs for these groups at the end of 1988. The Tax Reform Act has only contrib-

on single family residences. *See supra* note 7. *See generally* Brunken, Tax-Exempt Mortgage Revenue Bonds: Another Case of "Opiate Economics"?, 11 Loy. U. Chi. L.J. 473 (1980); Broadus, The Mortgage Subsidy Bond Tax Act of 1980: A Step in the Wrong Direction, 9 Fla. St. U.L. Rev. 469 (1981).

Issuers of mortgage revenue bonds may also elect to trade in portions of their mortgage revenue bond authority in order to issue tax credits to low- and moderate-income homeowners. *See* I.R.C. § 25 (1986) (providing for tax credits to homeowners holding "mortgage credit certificates" issued in lieu of mortgage revenue bonds).

10. *See, e.g.*, Mortgage Subsidy Bond Tax Act of 1980, *supra* note 7; Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified at I.R.C. § 1 *et seq.* (1982 & Supp. III 1985)); Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (codified at I.R.C. § 1 *et seq.* (1982 & Supp. III 1985)). For brief accounts of the pre-Tax Reform Act debate concerning proposed legislative amendments to multi-family housing bond programs, *compare* Tax Exempt Rental Housing Bonds: A Tax Subsidy Gone Awry, 28 Tax Notes 9 (1985) (critique of pre-1986 Tax Reform program) *with* Subcommittee Urged to Retain Multi-Family Housing IDBs, 28 Tax Notes 606 (1985) (support for pre-1986 Tax Reform program).

11. *See, e.g.*, Tax-Exempt Bonds for Multi Family Residential Real Property: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means, 99th Cong., 2d Sess. (1985) (statement of Mikel M. Rollyson, Tax Legislative Counsel, Department of the Treasury) [hereinafter Rollyson]; U.S. General Accounting Office, Report to the Chairman, Joint Comm. on Taxation, Home Ownership: Mortgage Bonds are Costly and Provide Little Assistance to Those in Need (1988) [hereinafter GAO Report]; Beek, Rethinking Tax Exempt Financing for State and Local Governments, Fed. Res. Bank. N.Y.Q. Rev. 30-31 (Autumn 1982).

12. *See, e.g.*, Cong. Budget Office Study, House Comm. on Banking, Finance, and Urban Affairs, 96th Cong., 1st Sess., Tax-Exempt Bonds for Single-Family Housing (Comm. Print 1979); GAO Rep., *supra* note 11 (mortgage revenue bonds).

uted further to the nation's crisis in affordable housing and has removed the federal government from its traditional leading role in providing safe, decent, and affordable housing for its citizens. It is distressing that the legislative process of fiscal review, unmindful of housing concerns, has had such a dramatic and negative impact upon housing policy.

I. A Brief History of Tax-Exempt Housing

Since 1913, when the first income tax was enacted,[13] the federal government has provided an exemption for interest on bonds issued "by or on behalf of" state and local governments.[14] Tax-exempt bonds were typically issued as general obligation debt backed by the taxing power of the issuer to carry out "fundamental" governmental purposes, such as providing water and sewer services, electric generation, and schools, roads, and highways.[15] As the New Deal broadened government's role in the daily life of America, state and local governments began to use bond financing to subsidize private business activities that were deemed to serve a "public purpose."[16] Over the past fifty years, an ever-increasing amount of tax-exempt bonds have been issued to finance private ventures such as the redevelopment of blighted urban areas, the provision of jobs through industrial development loans to private businesses, and the subsidization of privately owned housing.[17]

Revenue bonds have financed most of these privately owned ventures. Unlike a general obligation bond,[18] which is backed by the full faith and credit of the state or political subdivision that issued it, a revenue bond[19] is secured by and payable solely from the income stream generated by the facilities or programs financed with the bond proceeds. When issuing a revenue bond, the political subdivision often acts solely as a conduit having no obligation, and fre-

13. Tariff Act of 1913, Pub. L. No. 63-16, 38 Stat. 114, ch. 16.

14. *Id.* at 168. Interest on municipal bonds had been treated as exempt from most state and local taxes long before the enactment of this act. *See generally* Adymy, The Constitutionality of Federal Income Taxation of Interest Earned on State and Municipal Bonds, 50 Alb. L. Rev. 55 (1985). However, the Supreme Court recently ruled that the Federal tax exemption for state and local government bonds is not constitutionally mandated. South Carolina v. Baker, 108 S. Ct. 1355 (1988).

15. *See generally* Zimmerman, Limiting the Growth of Tax-Exempt Industrial Development Bonds: An Economic Evaluation 5 (1984).

16. *Id.* at 6-7.

17. *See generally* Lamb & Rappaport, Municipal Bonds 4, 14-16 (1980).

18. *Id.* at 9, 14.

19. *Id.* at 14-15.

quently no authority, to use tax revenues to cover any shortfall in revenues.

Historically, there were few restrictions upon the issuance of tax-exempt bonds by state and local governments and their political subdivisions.[20] The 1960s saw a sharp increase in the volume of tax-exempt revenue bonds issued for quasi-public purposes[21] as state and local governments recognized that by issuing revenue bonds they could shift risk to bondholders and cost to federal taxpayers.[22] In response to this trend, the Internal Revenue Service proposed restrictions limiting the issuance of bonds to certain prescribed "public purposes."[23] As adopted by Congress, one of these sanctioned purposes was the issuance of bonds to construct residences for families.[24] Congress imposed very few restrictions on this program.[25] For example, there was no requirement that the subsidized housing be reserved for any particular low- or moderate-income group or even be multi-family rental housing. Indeed, the regulations promulgated in 1972 explicitly provided that tax-exempt bond financing was available for the provision of "standard housing, either single or multi-family and either [rental] or owner-occupied."[26] Hence, virtually any residential family development could qualify for tax-exempt bond financing.

Commencing with New York in 1960,[27] states began to enact legislation providing for state[28] and local[29] housing finance agencies (HFAs) to finance a wide range of private housing programs designed to provide decent and affordable housing for low- and

20. *See generally* Adymy, *supra* note 14.
21. *See* Joint Comm. on Taxation, 99th Cong., 2d. Sess., Tax Reform Proposals: Tax Treatment of State and Local Government Bonds 32 (Jt. Comm. Print 1985).
22. Traditionally, state and local governments had borrowed against the tax base of the governmental entity in order to raise funds for public purposes. In that situation, the governmental unit, and more importantly the taxpayers, had to bear both the risks and costs of the borrowing. When mortgage revenue bond issues are substituted for direct governmental debt, the risk of the borrowing is transferred to the bondholders and the costs are shifted to the federal taxpayer through the tax subsidy for the tax-exempt bonds.
23. Prop. Treas. Reg. § 1.103-7, 33 Fed. Reg. 4940 (1968).
24. Revenue and Expenditure Control Act of 1968, Pub. L. No. 90-364, 82 Stat. 251, 267 (1968) (codified as amended at I.R.C. § 103(b)(4)(A) (1984)).
25. The legislative history of the 1968 Act exemption for "residential real property for family units" contains no reference to restricting the exemption to low- or moderate-income or other target groups. H.R. Rep. No. 1533, 90th Cong., 2d Sess. 32, 36-38, *reprinted in* 1968 U.S. Code Cong. & Admin. News 2373, 2383-85.
26. Treas. Reg. § 1.103-8(b). For a commentary on these regulations, see Pollak, *supra* note 7, at 585-86.
27. N.Y. Pub. Hous. Law. §§ 340-57 (McKinney 1960) (later repealed).
28. *See, e.g.*, 1966 Mass. Acts 708, as amended.
29. *See, e.g.*, 1988 R.I. Pub. Laws 10.

moderate-income families and individuals and to meet special housing needs for groups such as the elderly and the homeless.[30] HFAs now exist in nearly every state, plus the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Some agencies are part of state government, but the majority are independent or quasi-independent bodies. HFAs generally are run on a day-to-day basis by a paid, full-time staff and governed by an appointed board of directors comprised of *ex-officio* government officials, representatives of the housing and banking industries, and members of the general public. Although some state agencies receive state appropriations for their programs, most HFAs depend on the ability to issue tax-exempt bonds to finance these housing programs.

During the late 1970s, the volume of housing bonds increased rapidly. The annual volume of multi-family housing bonds rose from $900 million in 1975 to $2.9 billion in 1977, and then declined slightly to $2.7 billion in 1979. During the same period, the volume of mortgage revenue bonds escalated from less than $50 million in 1975 to $7.8 billion in 1979.[31] Clearly, spiraling inflation contributed to this growth. The inflationary economy of the 1970s produced high interest rates that, in turn, pushed up rents, and also resulted in conventional mortgage interest rates rising beyond the reach of many low- and moderate-income families. The demand for below market rate financing grew commensurately. It has also been argued that the policies of fiscal constraint that dominated budget debates throughout this period produced a decline in direct federal expenditures in housing programs.[32] Concomitant with the increased volume of housing bonds was a heightened concern with perceived "abuses" of these programs, such as the provision of "luxury" apartments, and federal revenue losses associated with the increased volume of tax-exempt financing.

Prior to enactment of the Tax Reform Act, legislation had been introduced on three different occasions during the 1980s to restrict housing programs to low- and moderate-income families and individuals.[33] The political climate of the late 1970s and 1980s that en-

30. HFAs must be distinguished from public housing authorities that were associated with well-publicized high-rise housing developments in the 1960s. The advent of the HFA signaled the beginning of the privatization of the provision of decent and affordable housing for low-income renters and home buyers.

31. Rollyson, *supra* note 11, at Table 1; Joint Comm. on Tax'n, 96th Cong., 1st Sess., Background and Issues Regarding H.R. 3712 Relating to Tax-Exempt Bonds for Housing 48 (Jt. Comm. Print 1979).

32. *See* Rollyson, *supra* note 11, at 4-5.

33. *See* acts cited *supra* note 10.

couraged cutbacks in public spending at all levels of government fostered the view that federal housing supplements (direct or indirect) should be available only to those who could not otherwise afford decent quality housing, and not to higher income persons. Although these legislative restrictions targeted housing bond proceeds toward more needy groups, they did not result in a decline in the construction of multi-family rental developments or in the volume of tax-exempt financed mortgages for low- and moderate-income households.[34] Indeed, these restrictions evidenced the federal government's commitment to providing or spurring private development of decent housing. The restrictions rightly targeted those segments of society most in need of assistance.

The mechanisms for ensuring that tax-exempt bond financing was targeted toward low- and moderate-income groups differed for multi-family rental housing bonds and single family mortgage bonds. With respect to multi-family rental housing financings, since 1982 developers have generally been required to set aside at least 20% of the units constructed using tax-exempt bond proceeds for persons of "low- or moderate-income."[35] With regard to single family mortgage bonds, Congress adopted a series of targeting mechanisms rather than imposing income limits on prospective home buyers. The primary targeting mechanisms were purchase price limits and the "first-time home buyer" rule. Purchase price limits imposed a ceiling on the cost of a residence that could be financed with tax-exempt bond proceeds.[36] These purchase price limits generally restricted tax-exempt mortgage financing to residences located in low- and moderate-income areas or to housing generally below the median price for an area, housing that would not appeal to higher income bracket purchasers who could afford more prestigious homes. Congress also limited the availability of mortgages financed through the issuance of qualified mortgage

34. *See* Rollyson, *supra* note 11, at 4 (multi-family rental housing developments); GAO Rep., *supra* note 11, at 10-11 (tax-exempt mortgages).

35. I.R.C. § 103(b)(4)(A)(ii) (1984). Only a 15% set aside was required for developments in targeted areas. I.R.C. § 103(b)(4)(A)(i) (1984). An eligible "low- or moderate-income" resident was a tenant who, at the time of occupancy, did not have an adjusted income, computed under Treas. Reg. § 1.167-k(3)(b)(3) (1984), in excess of 80% of the gross median income for the applicable area as established by the Department of Housing and Urban Development. I.R.C. § 103(b)(12)(C) (1984).

Unfortunately, the legislative history concerning these set-aside requirements provides virtually no clue as to why the 20% figure was determined to be the appropriate minimum level of low-income dwellings. *See* Tax Treatment of Mortgage Subsidy Bonds: Hearings on H.R. 3712 Before the House Comm. on Ways and Means, 96th Cong., 1st Sess. 3 (1979).

36. I.R.C. § 103A(f) (1984).

bonds to people who had not owned a residence in the past three years.[37] This restriction rendered a substantial number of potential borrowers ineligible for tax-exempt mortgages. In addition, at least 20% of the lendable proceeds of a qualified mortgage bond issue was required to be reserved for at least one year to make loans for the purchase of homes in "targeted areas."[38] Targeted areas were defined to include both "qualified census tracts" in which at least 70% of the families had annual incomes no higher than 80% of the statewide median income,[39] and designated areas of chronic economic distress.[40]

In order to limit federal revenue losses through qualified mortgage bond financings, Congress imposed an annual limit on the dollar amount of mortgage revenue bonds that could be issued by each state[41] and provided that the federal authorization for qualified mortgaged bonds expire December 31, 1987.[42]

II. The Tax Reform Act of 1986

The Tax Reform Act of 1986,[43] which curtailed the issuance of all forms of tax-exempt debt, imposed further restrictions on the issuance of tax-exempt housing bonds.[44] These new restrictions, when coupled with other new limits on the tax advantages of owning real estate generally,[45] are producing a dramatic and long-term negative

37. I.R.C. § 103A(e) (1984). Rev. Proc. 82-16, 1982-1 I.R.B. 461, established procedures for verifying satisfaction of the three-year requirement through use of information from income tax returns.

38. I.R.C. § 103A(h)(i) (1984).

39. I.R.C. § 103A(k)(2) (1984). *See* Rev. Proc. 83-51, 1983-2 I.R.B. 555, for a list of qualified census tracts.

40. I.R.C. § 103A(k)(3) (1984). The aggregate population in all areas of chronic economic distress within any state may not exceed 20% of that state's total population, excluding the population already included in qualified census tracts. Rev. Proc. 81-30, 1981-2 I.R.B. 555, sets forth the procedures for requesting approval of a state designation as an "area of chronic economic distress."

41. I.R.C. § 103A(g) (1984). The ceiling applicable to any state for any calendar year was the greater of $200 million or 9% of the average annual aggregate principal amount of mortgages exempted during the immediately preceding three calendar years for single family owner-occupied residences within the state.

42. I.R.C. § 103A(c)(1)(B) (1984).

43. Tax Reform Act, *supra* note 2.

44. Tax Reform Act, *supra* note 2, at § 1301(b).

45. *See, e.g.,* I.R.C. § 168 (1986) (modifying the § 168 Accelerated Cost Recovery System of depreciation by extending the recovery period to 27.5 years for residential rental property); I.R.C. § 42 (1986) (providing that the cost of low-income housing be recovered over 27.5 years on a straight-line basis instead of a 15-year declining balance method, and that low-income housing is no longer exempt from the capitalization requirements for construction period interest and taxes); I.R.C. § 469 (1986) (allowing losses and credits from post-1986 passive activities only to the extent of income from and tax liability allocable to such activities).

effect on the production of low- and moderate-income housing in America.

At a general level, the Tax Reform Act has curtailed the ability of HFAs to issue tax-exempt debt and has thereby reduced those agencies' ability to finance subsidized housing. The Act restricts the availability of tax-exempt housing finance by making both multifamily and single family housing bonds subject to a state volume cap on private activity bonds.[46]

Section 146 of the Internal Revenue Code of 1986 (the Code) imposes a volume cap on the aggregate amount of private activity bonds that any state may issue annually. In 1987, the volume cap was equal to the greater of $250 million or an amount equal to $75 multiplied by the population of the state.[47] Each state's volume cap was further reduced in 1988.[48] Thus, HFAs must now compete with industrial development authorities and other state agencies and private activity bond issuers for a share of the limited state volume cap.[49] A single tax-exempt financed solid waste disposal facility, for example, could conceivably use a major portion of the volume cap of many states.[50]

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46. I.R.C. § 146 (1986). The term "private activity bonds" as used in the Code refers to exempt facility bonds as defined in I.R.C. § 142(a) (1986), mortgage bonds, veteran's mortgage bonds, small issue bonds, student loan bonds, redevelopment bonds and 501(c)(3) bonds (available for non-profit organizations). I.R.C. § 141(d) (1986).

47. I.R.C. § 146(d)(1) (1986).

48. I.R.C. § 146(d)(2) (1986).

49. Notwithstanding the view of Congress and the Treasury Department of what constitutes a proper "public purpose," many state and local governments believe that privatization of various governmental functions, such as waste disposal, operation of correctional facilities, and mass transportation, will permit provision of these services at lower cost to their taxpayers. Unfortunately, the new rules created by the Tax Reform Act will limit the ability of state and local governments to finance these activities. Many of these projects will either be financed on a taxable basis or will be done on a tax-exempt basis, using a portion of the annual volume cap. State and local governments will face difficult policy decisions in attempting to choose between providing additional affordable housing and, for example, building resource recovery facilities to deal with the growing problem of waste disposal.

50. For example, a solid waste disposal facility under construction in Massachusetts has already used $150 million of the annual volume cap, which represents approximately half of the available tax-exempt private activity bond volume cap in the state, and the facility developers are currently applying for more bond proceeds to finance a project expansion. When a solid waste disposal facility servicing only a small geographic area within the state uses $150 million of tax-exempt private activity bonds, and the Massachusetts Housing Finance Agency issues approximately $62 million of mortgage revenue bonds and $108 million of multi-family housing bonds as it did in 1987, Massachusetts' private activity volume can be easily used without reference to any other public purposes such as the redevelopment of urban areas or the issuing of student loan funds (data on file with authors).

Revisions to the "arbitrage" rules in the Code have further limited the funds available for housing projects.[51] Prior to the Tax Reform Act, it was possible to earn a limited amount of arbitrage profit on bond proceeds. This arbitrage profit could then be invested in the facility or program. In the case of a mortgage revenue bond issue, the arbitrage profit is the difference between the yield on the bonds and the expected rate of interest on the mortgages purchased with the bond proceeds. Section 148 of the Code now provides a complex set of rules that either prohibit the making of arbitrage profits or require that these profits be rebated to the United States.[52] In the case of mortgage revenue bonds, the issuer may also elect to rebate profits to the mortgagors.[53] When structuring a multi-family housing financing, an HFA may no longer apply investment earnings to the payment of project costs during the construction period and therefore must either finance a smaller, less expensive development or increase the size of the borrowing to cover the earnings now subject to "rebate."

Other specific provisions of the Code have limited the tax advantages of purchasing tax-exempt housing bonds, making bond-financed housing less attractive to the developers and bond investors. The reduction in the marginal tax rates effected by the Tax Reform Act has reduced the "benefit" of receiving tax-exempt interest income. This may reduce the demand for tax-exempt debt and thereby increase the cost of borrowing for all issuers, including HFAs. In addition, as a result of the Tax Reform Act, the Code requires that interest on housing bonds be included in the calcula-

51. I.R.C. § 148 (1986). The disparity between taxable and tax-exempt interest rates creates situations where HFAs and developers can invest the proceeds of lower-cost tax-exempt bonds in higher-yielding taxable investments in order to generate an "arbitrage" profit. For example, if an HFA can borrow funds at an 8% tax-exempt rate and invest the bonds proceeds in taxable obligations yielding 10%, it can profit by the interest rate differential of 2% per year. Section 148 prohibits this form of "investment earnings." For pre-Tax Reform Act exceptions, see I.R.C. § 103(c) (1984).

As issuers and developers increasingly explored avenues for exploiting the limited exceptions to realize arbitrage profits, the Tax Reform Act imposed rebate rules to govern these "investment earnings." Under the 1986 Code, with few exceptions, amounts earned from the investments of "gross proceeds" in excess of the yield of the bonds must be rebated to the United States Treasury at least every five years. I.R.C. § 148(f) (1986). Although the pre-Tax Reform Act arbitrage exceptions—"temporary periods," "reasonably required reserve or replacement funds," and "minor portion"—are still retained in the 1986 Code, the impact of the rebate rules is to nullify these arbitrage profit opportunities.

For a brief discussion of the changes in the arbitrage rules under the Tax Reform Act, see generally Arey & O'Connor, Tax-Exempt Obligations after the Tax Reform Act of 1986—Brief for the Local Government Attorney, 19 Urb. Law 1051, 1056-61 (1987).

52. I.R.C. § 148(f)(2) (1986).

53. I.R.C. § 143(g)(3)(A) (1986).

tion of the alternative minimum tax imposed on corporations and individuals.[54] This has resulted in decreased demand by pension funds, insurance companies, and other traditional institutional purchasers of housing bonds. Broadening the base for alternative minimum tax has produced higher interest rates for tax-exempt housing bonds and, in turn, increased housing costs for both low- and moderate-income renters and home buyers.

At the programmatic level, the Tax Reform Act has drastically curtailed the financing of multi-family housing by tax-exempt bonds, and the one year extension of the expiration date for mortgage revenue bonds cannot sustain current single family housing bond programs.

A. *Multi-Family Housing Bonds*

The Tax Reform Act has tightened the low-income tenant requirements for multi-family housing projects financed by tax-exempt bonds[55] and has rendered investments in real estate less attractive for developers.[56] The cash flow from multi-family housing projects has thereby been reduced, providing a disincentive to the development of low- and moderate-income rental housing.

Under the Act's new set-aside requirements for low-income tenants, an issuer must select one of two set-aside requirements for a project by the time the bonds are issued. Either a minimum of 20% of a project's units must be occupied by tenants with annual incomes of 50% or less of area median gross income, or at least 40% of the units must be rented to tenants at or below 60% of area median gross income.[57] Unlike prior laws,[58] the new Code requires determination of whether a tenant qualifies as low- to moderate-income under the set-aside requirement on at least an annual basis, rather than only once at the time of initial occupancy.[59]

A tenant is treated as low-income for the purpose of meeting this requirement unless his or her income rises to a level greater than

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54. I.R.C. §§ 55-59 (1986). Under the provisions of these sections an individual or a corporate taxpayer must, in addition to computing its "regular" tax liability, compute its "alternative minimum taxable income" and its corresponding alternative minimum tax liability. I.R.C. § 55 (1986). If the alternative minimum tax liability exceeds the regular tax liability, it is imposed instead. I.R.C. § 55(a) (1986).

55. I.R.C. § 142(d) (1986).

56. I.R.C. § 148 (1986).

57. I.R.C. § 142(d)(1) (1986).

58. I.R.C. § 103(b)(4)(A) (1984) (repealed by Tax Reform Act, *supra* note 2, at § 1301(b)).

59. I.R.C. § 142(d)(3)(A) (1986).

140% of the maximum applicable income level that qualified him or her as low-income.[60] A tenant whose income exceeds 140% of the maximum applicable income will no longer be treated as occupying a low-income dwelling that counts toward compliance with the set-aside requirement.[61] The Conference Committee Report to the Tax Reform Act indicates that Congress did not intend for tenants who cease to qualify as low-income to be evicted in order to restore a project to compliance with the set-aside requirement.[62] Instead, penalties will not be imposed for non-compliance so long as the next vacant project unit of comparable or smaller size is rented to a qualified low-income tenant in order to return the project to compliance.[63]

This new set-aside restriction has rendered many multi-family rental-housing bond financings uneconomical and has resulted in a sharp decline in the volume of multi-family residential rental bonds issued since 1985.[64] Prior to this restriction, the revenue stream from the market-rate rental units in a mixed development offset the low-level cash flow from the set-aside dwellings. As the result of the more stringent set-aside requirement under the Tax Reform Act, it is more difficult to produce an adequate cash flow from a project as a whole. When this provision is coupled with the recent cutbacks in of the United States Department of Housing and Urban Development (HUD) Section 8 rental assistance program,[65] and other provisions of the Tax Reform Act that have reduced the attractiveness of

60. I.R.C. § 142(d)(3)(B) (1986).

61. I.R.C. § 142(d)(3)(B) (1986).

62. Conf. Comm. Rep. No. 99-841, 99th Cong., 2d Sess. (1986), *reprinted in* Tax Reform Act of 1986: Law and Controlling Committee Reports (CCH) ¶ 8301 (1986).

63. I.R.C. § 142(d)(3)(B) (1986).

64. The volume of multi-family rental housing bonds fell 15.8% from $3.37 billion in 1986 to $2.84 billion in 1987. This decline follows an 84.5% drop in 1986 from the record volume of $21.8 billion in 1985. In comparison, new issues of single family mortgage bonds rose 11% from $7.52 billion in 1986 to $8.35 billion in 1987. This is still substantially below the $15.7 billion of single family housing mortgage revenue bonds issued in 1985. The Bond Buyer, Mar. 9, 1988, at 1, 23.

65. The Section 8 Rental Assistance Program is a rental subsidy program established under the United States Housing Act of 1937, *supra* note 5, as amended by the Housing and Community Development Act of 1974, *supra* note 5. This program provides subsidies to landlords to cover the difference between the rent charged for a dwelling and the rent that a low-income resident can afford to pay for housing (which is computed as a designated percentage of income). The Section 8 subsidy is paid directly to a landlord on the tenant's behalf, but the tenant chooses where to live and may transfer residences without losing the benefit of the program. Subsidized units must meet certain quality standards set by HUD. With concern over budget deficits mounting, Congress, in the Housing and Urban-Rural Recovery Act of 1983, Pub. L. No. 98-181, 97 Stat. 1159 (codified in scattered sections of 42 U.S.C.), repealed the authorization for Section 8 new construction and substantial rehabilitation. The federal government, however, remains obligated to provide subsidies for units under existing housing assistance pay-

real estate investments generally, the production of multi-family bond-financed housing has sharply declined.

To replace some of the tax benefits that traditionally went to developers of low-income housing, the Tax Reform Act provides a new low-income housing tax credit program for multi-family rental housing.[66] The tax credit, which is only available to developers building affordable rental housing for needy, low-income families and individuals, is based upon the number of units made available to low-income tenants.[67] To qualify, a project must meet requirements similar to the minimum low-income set-aside requirement for multi-family rental housing bonds.[68] In addition, the Code limits the rent that may be charged to low-income tenants in units which qualify for the tax credit.[69]

Although the tax credit has been available for only approximately eighteen months, data indicate that few investors have taken advantage of the credit since its enactment.[70] The limitations that the Tax Reform Act has imposed on the value of tax credits in general dilutes the ability of this new tax vehicle to provide an incentive for substantial numbers of new multi-family housing developments. Developers are now limited to $25,000 of tax losses and credits for all business operations, and even these benefits are phased out

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ments contracts. Because of the long term of these contracts, federal assistance for units in the existing Section 8 housing program will continue into the next century.

66. I.R.C. § 42 (1986). As of 1987, the low-income housing tax credit was 9% of the "qualified basis" of each low-income building. The credit may be applied in conjunction with tax-exempt bond financing or other federal subsidies, but the credit is reduced to 4% for buildings which are federally subsidized for the applicable taxable year. I.R.C. § 42(b)(1) (1986). *See generally* Stearns, The Low-Income Housing Tax Credit: A Poor Solution to the Housing Crisis, 6 Yale L. & Pol'y Rev. 202 (1988); Callison, New Tax Credit for Low-Income Housing Provides Investment Incentive, 66 J. Tax'n 100 (1986); Carlisle, The Credit for Low Income Housing: Whose Shelter is it?, 3 Real Est. Fin. 44 (1987); Delta, A Critique of the Low-Income Housing Credit, 3 Tax Mgmt. Real Est. J. 114 (1987).

67. I.R.C. § 42(d)(3) (1986).

68. I.R.C. § 42(g)(1) (1986).

69. I.R.C. § 42(g)(2) (1986).

70. Data compiled by the National Counsel of State Housing Agencies (NCSHA) indicate that states allocated about $65 million (20%) of the $317 million low-income housing tax credit authority they had available during 1987. The credit program tended to be the most successful where state subsidies could be coupled with the tax credit. For example, Massachusetts, which has developed a state-funded rental subsidy program, allocated the most tax credit in 1987, awarding $6.2 million (55%) out of $11.17 million available. *See* Ideas and Trends, 15 Hous. & Dev. Rep. (BNA) 787 (Mar. 7, 1988). NCSHA Executive Vice President Carl W. Reidy, Jr., noted that state agencies generally considered multi-family projects to be unfeasible with the credit alone. In his view, the difficulty also stems from the programs' complexity and the lack of federal regulations governing the administration of the programs. *Id.* at 788.

when adjusted gross income reaches a certain level.[71] Thus, only relatively small developers are able to reap the full benefit of the tax credit provisions. Members of both houses of Congress introduced legislation on March 1, 1988, to amend the Code limits on use of the low-income housing credit in order to make the credits more attractive to investors.[72] Ironically, the Tax Reform Act has created disincentives to the production of new multi-family rental housing despite the critical need to increase the stock of decent and affordable rental housing for needy families and individuals.

B. Single Family Mortgage Bonds

The Tax Reform Act established the first federal income restrictions for recipients of mortgage loans financed by tax-exempt bonds, although the vast majority of state and local issuers had previously imposed their own income limits.[73] Under the Act, the annual income of a borrower may not exceed 115% of the median family gross income for the state or the area in which the residence is located, whichever is greater.[74] A different standard, however,

71. I.R.C. § 469 (1986). Currently a taxpayer may use the tax credit only to offset tax liability from "passive activities." Under this section a "passive" activity will generally be any activity involving the conduct of trade or business in which a taxpayer does not materially participate. Any rental activity, including rental real estate, will be passive activity without regard to whether the taxpayer materially participates.

72. H.R. 4048, 100th Cong., 2d Sess. (1988); S. 2115, 100th Cong., 2d Sess. (1988). Under the proposed legislation, current limits on the use of the low-income housing tax credit would be replaced by existing tax law limits on use of business credits. For a brief review of current limits on the use of the credit, see Stearns, *supra* note 66, at 209-11.

The proposed legislation also permits non-profit organizations to join private investors initiating and financing housing projects. The use of the low-income housing tax credit by a non-profit corporation is, however, problematic. Non-profit corporations cannot use the credit to offset their own tax liability. Rather, they must transfer the tax credit to their private partners in exchange for equity financing. Then, even if an applicable financial structure can be determined, the costs of syndication may be prohibitive for non-profit corporations without sufficient financial backing to afford the highly specialized legal and financial assistance required in the development and administration of public-private alliances. *See* Stearns, *supra* note 66, at 217-23. For a general discussion of the role of non-profit corporations in the provision of tax-exempt multi-family rental developments, see Note, Low Income Housing Under the New Conservatism: Trickle Down or Dry Up?, 26 Santa Clara L. Rev. 461 (1986).

73. Ninety-eight percent of the HFAs had "[set] income and/or purchase price limits at the state level before and/or below the federally established limits [in the Tax Reform Act]." Nat'l Ass'n of Home Builders, Nat'l Ass'n of Realtors, Nat'l Council of State Housing Agencies, & Ass'n of Local Housing Finance Agencies, A Referendum on the American Dream: A Rebuttal of the General Accounting Office of the United States' Report on Qualified Mortgage Revenue Bonds 29 (1988) [hereinafter Referendum on the American Dream] (emphasis deleted).

74. I.R.C. § 143(f)(1), (4) (1986). The Code further provides that "the family income of mortgagors, and area median gross income, shall be determined . . . taking into account the regulations prescribed under Section 8 of the United States Housing Act of 1937." I.R.C. § 143(f)(2) (1986).

applies to home buyers purchasing residences in targeted areas. At least two-thirds of the mortgage financing provided in targeted areas must go to borrowers with incomes not exceeding 140% of the higher of the state or area median family gross income; the remainder of the bond proceeds set-aside for the targeted area may be loaned without income restriction.[75] By enabling HFAs to adjust the median area gross income figure for family size, the Code does not discriminate against large low- and moderate-income families.[76]

Although the Tax Reform Act subjects single family programs to the burden of income restrictions upon potential home buyers, the Act has affected these programs less than it has multi-family rental housing. To a large extent, Congress did not focus attention upon mortgage revenue bond programs because of their pending sunset in 1987. In fact, the Tax Reform Act extended the sunset for mortgage revenue bonds from December 31, 1987, to December 31, 1988.[77] At present, there is substantial support in both houses for bills to extend the sunset until December 31, 1991.[78] The General Accounting Office (GAO) released a study on March 21, 1988,[79] claiming that most tax-exempt mortgage loans are given to borrowers who do not need financial aid to purchase a house and arguing that, therefore, the scheduled expiration of this program should not be amended.

III. Criticisms of Tax-Exempt Housing Bond Financing.

In spite of the Tax Reform Act initiatives aimed at restricting the application of multi-family rental bonds and mortgage revenue bonds to low- and moderate-income families and individuals, there is still considerable criticism of the efficiency and effectiveness of these programs. The efficiency criticism is concerned with whether an appropriate proportion of the federal revenue applied to tax-exempt financing benefits housing, while the effectiveness criticism focuses on whether these financings assist those most unable to obtain

75. I.R.C. § 143(f)(3) (1986).

76. *See* Rev. Rul. 86-124, 1986-2 C.B. 27. This ruling contains guidelines prescribing the manner in which the income limits are to be applied. The income limits may be adjusted for smaller and larger families if these adjustments are made with respect to all owner-financing provided under a tax-exempt bond issue. *Id.* at 28.

77. I.R.C. § 143(a)(1)(B) (1986). It should be noted that the Tax Reform Act also changed the name of "mortgage subsidy bonds" to "mortgage revenue bonds."

78. H.R. 2640, 100th Cong., 1st Sess. (1987); S. 1522, 100th Cong., 1st Sess. (1987). As of April 22, 1988, H.R. 2640 had a total of 325 cosponsors out of 435 Representatives, and S. 1522 had 67 cosponsors in the Senate.

79. GAO Report, *supra* note 11.

decent and affordable housing. Whereas the effectiveness arguments are program specific, the efficiency argument is part of the general critique of indirectly subsidizing quasi-public projects through tax-exempt financing.

A. *The Efficacy of Multi-Family Housing Bonds*

Prior to the enactment of the Tax Reform Act, the 20% set-aside requirement for rental units constructed with tax-exempt bond proceeds had come under considerable attack for being too shallow a target to have a significant impact upon the provision of decent and affordable rental housing for low-income families and individuals.[80] In a 1986 report issued prior to the Tax Reform Act, the GAO contended that multi-family housing bonds often only helped moderate-income people obtain better quality rental housing[81] because households with incomes substantially higher than the average renter could qualify as low- or moderate-income households.[82] The GAO further questioned whether the fiscal benefits associated with tax-exempt financing were passed on to low- and moderate-income renters, "pocketed" by the developer, or "soaked up" by the transaction costs of the tax-exempt financing.[83] It could be hypothesized that the decline in new multi-family rental developments since the advent of the stricter set-aside requirement under the Tax Reform Act is evidence that the three percentage point reduction in interest rates developers receive from a tax-exempt financing only enhances developers' profits.[84] But, arguably, this is also evidence that the stringent set-aside requirements and other provisions of the Tax Reform Act, together with the decline in funds available under other federal rent-subsidy programs, have rendered multi-family developments uneconomical.[85] It is still too soon after the enactment of the Tax Reform Act for available data to support a definitive answer.

At a general level, the question of whether multi-family housing bonds are sufficiently targeted to allow low-income families to rent decent and affordable housing is more complex than many critics of

80. U.S. General Accounting Office, Report to the Chairman, Joint Comm. on Tax'n, Rental Housing: Cost and Benefits of Financing With Tax-Exempt Bonds (1986) [hereinafter Rental Housing Report].

81. *Id.* at 17-19.

82. *Id.* at 19-23.

83. *Id.* at 38-43. The Rental Housing Report contended that without data on the profitability of alternative developer opportunities, it was not possible to definitively answer this question. *Id.* at 39-40.

84. *Id.* at 39.

85. *See supra* notes 55-65 and accompanying text.

these programs concede. First, not all low-income housing programs are designed to, or will, in fact, assist the *very* needy. The low- and moderate-income group is heterogeneous and consists of various sub-sectors such as the poor, the elderly, first-time home buyers, and those of moderate income seeking an income supplement for upward mobility. It may be unrealistic to expect an indirect subsidy such as tax-exempt financing to be an effective tool for deep-targeting very-low-income housing problems. Tax-exempt bonds are sold to investors who expect to be repaid. The interest costs of bonds are directly related to investors' evaluation of the credit risk associated with a particular bond issue. As very-low-income households are not good credit risks without rent supplements like the Section 8 program, investors would lack confidence in the anticipated cash flow from a 100% very-low-income development. Thus the bonds might not be marketable at a viable interest rate. Viewed from this marketplace perspective, the pre-Tax Reform Act residential rental housing programs may not have been as inefficacious as GAO contends. They have assisted many low- and moderate-income families and individuals in obtaining better quality rental housing in mixed-income developments. The housing situation of very-low-income groups may be best addressed by direct subsidy programs.

B. The Efficacy of Single Family Mortgage Bonds

The 1988 GAO Report typifies the criticism of the effectiveness of single family mortgage bond issues. This report, based on the examination of 178,000 loan files from 32 state and local housing agencies around the country, concludes that revenue bonds issued to finance loans for single family housing accomplished little public good for the tax revenue forgone.[86] The GAO Report claims that two-thirds of the loans it examined were received by people who could have afforded to buy the same house on the same day with a conventional fixed-rate mortgage or an adjustable-rate mortgage.[87] Of the remaining one-third of borrowers who could not have purchased a house when they did without the subsidized mortgage, many were younger than first-time home buyers in general.[88] In addition, the GAO Report contends that many of this remaining group

86. GAO Report, *supra* note 11, at 3-4.
87. *Id.* at 30.
88. *Id.* at 19, 25.

of borrowers could still have qualified for conventional financing for a house costing approximately 10% less than the one they bought.[89]

The methodology of the GAO Report has come under severe criticism. First, housing finance officials have charged that the GAO used lax underwriting standards in determining whether the people who received tax-exempt mortgages could have received loans from conventional lenders.[90] In particular, it failed to take into account the additional underwriting burdens placed upon first-time home buyers. Second, the GAO Report compared mortgage bond subsidized loans with all other types of loans, including loans that are obtained with other types of subsidies such as Federal Housing Administration insurance or Veteran's Administration assistance.[91] To support its conclusions, the GAO Report should have compared mortgage bond loans with conventional financing alone. Finally, the loans that the GAO Report examined were made before the enactment of the Tax Reform Act,[92] which subjects loans from qualified mortgage bond proceeds to new purchase price and income limitations. Thus, even if the first two criticisms of the GAO Report are unfounded, post-Tax Reform Act tax-exempt mortgages are more likely to be targeted to low-income home buyers because of the new income restrictions.[93]

Serious questions remain as to whether mortgage subsidy bonds are intended to, or ought to, deep-target the very-low-income home buyer. As is the case with multi-family residential rental housing, mortgage subsidy bonds must be marketable at an interest rate low enough to produce tax-exempt mortgage rates significantly lower than rates obtainable in the conventional mortgage market. A viable price for the bonds cannot be achieved if subsidized mortgages are only to be produced for very-low-income (and therefore poor credit risk) households. However, to the extent that these programs generate greater movement within the housing market and enable relatively higher-income groups to own homes, they may make available more housing for very-low-income persons most in need of assistance.

Tax-exempt financing coupled with *direct* federal subsidies would greatly enhance the efficacy of both multi-family residential rental and mortgage subsidy bond programs. To withhold direct subsidies

89. *Id.* at 33.
90. Referendum on the American Dream, *supra* note 73, at 13-18.
91. *Id.* at 5-6.
92. *Id.* at 21-24.
93. *See* notes 73-76 and accompanying text.

and then to argue that these tax-exempt housing programs are ineffective will not produce more and better affordable housing for low- and moderate-income persons.

C. *The Efficiency of Tax-Exempt Housing Bonds*

The GAO Report estimated that for every dollar of federal revenue that is applied to tax-exempt mortgage bonds, the average benefit to the subsidized mortgage recipient is less than 30 cents.[94] The other 70 cents is accounted for by factors including underwriter fees, bond counsel fees, and other administrative costs incurred by HFAs. Although the efficiency of the federal dollar in tax-exempt financings is hotly disputed,[95] the issuance of tax-exempt bonds is clearly not a process free of significant transaction costs. Two problems appear when the GAO Report's use of the statistics on the efficiency of this indirect subsidy is analyzed. First, the statistics do not specify what efficiency level would be acceptable. This omission is significant because any alternative housing program involving either direct or indirect subsidies would probably involve significant transaction costs. Second, efficiency is not the only criterion by which we should judge tax-exempt housing programs.[96] The unavoidable inefficiencies of these housing programs must be balanced with the social values and concerns they serve—including the immediate need to increase the stock of decent and affordable subsidized housing in America. It is difficult to argue on efficiency grounds that tax-exempt housing programs should be abolished when they are the only federal programs currently addressing America's affordable housing crisis.

IV. *Toward a Comprehensive Review of Housing Policy in the 1980s*

At a time when housing production programs for those with low incomes are failing to keep pace with the growth in the number of low-income households,[97] the Tax Reform Act has further eroded the resources available for the production of new tax-exempt low- and moderate-income housing. The Tax Reform Act, when com-

94. GAO Report, *supra* note 11, at 62.
95. Referendum on the American Dream, *supra* note 73, at 21-74.
96. For a general critique of economic efficiency arguments which fail to address other social values, see Baker, Starting Points in the Economic Analysis of Law, 8 Hofstra L. Rev. 939 (1980); Kelman, Consumption Theory, Production Theory and Ideology in the Coase Theorem, 52 S. Cal. L. Rev. 669 (1979); Michelman, Norms and Normativity In The Economic Theory of Law, 62 Minn. L. Rev. 1015 (1978).
97. Clay, Risk of Loss: The Endangered Future of Low-Income Housing Resources 4 (1987); Apgar & Brown, *supra* note 1; Stearns, *supra* note 66, at 204-5.

bined with the lifting of HUD "user restrictions,"[98] could ultimately result in the "gentrification" of a substantial portion of the current federally subsidized low-income rental housing stock. Moreover, unless the sunset of mortgage revenue bonds is extended, the ability of low- and moderate-income persons to buy their own homes with affordable financing will be greatly diminished. This in turn will raise the price of rental housing and further exacerbate the affordable housing crisis.

The construction and maintenance of quality low-income rental housing stock and affordable opportunities for homeownership are vital. An increased number of rental units is necessary to satisfy the growing demand for such housing. The ability to obtain reasonably priced financing, such as that made available through the issuance of tax-exempt bonds, will enable many renters to become first-time home buyers. The rental housing previously occupied by these persons can be recycled over time to others most in need of housing assistance.[99] Because of the need to meet certain mortgage underwriting criteria, the subsidized mortgages purchased under single family programs tend primarily to assist those in the upper portion of the low- and moderate-income brackets. Yet these programs are still important for all income levels to the extent that they enable

98. The expiration of "user restrictions" on many HUD subsidized housing projects built in the late 1960s could result in the depletion of a substantial portion of the existing privately owned rental housing stock for those with low- and moderate-incomes. HUD regulatory agreements offer developers a prepayment option that enables them to escape the burden of "user restrictions" after 20 years of a 40-year mortgage. Accordingly, a large portion of current HUD subsidized rental housing could be "gentrified" by the end of this century. Congressional Budget Office, Staff Working Paper, The Potential Loss of Assisted Housing Units as Certain Mortgage-Interest Subsidy Programs Mature (Mar. 1987).

99. Various avenues for maintaining the affordability of single-family residences originally financed by tax-exempt bonds are being explored. One attempt to recycle subsidized single family housing is the Homeownership Opportunity Program instituted in Massachusetts. Under this program, a local community, for example, may donate a site to a developer who will then construct single family units and agree to sell a percentage of such units to certain qualifying low- and moderate-income persons and families at specified prices below the fair market value of such units. The individual home buyers will obtain mortgage financing from the Massachusetts Housing Finance Agency, which will further reduce their cost. In addition, the Commonwealth of Massachusetts has agreed to provide certain moneys to buy-down the effective interest rate on the individual mortgage loans. The purchaser of the property must agree that the property will be resold only to an eligible low- or moderate-income buyer at a price similarly discounted off the then–fair market value of the property. Thus, the subsidized single family housing will be recycled among low- and moderate-income families. The effectiveness of this program will depend, in part, on the continued availability of below market rate mortgage loans, such as those now provided by the Massachusetts Housing Finance Agency. The Housing Environment in Massachusetts, Report of the Massachusetts Housing Finance Agency 18-19 (July 1987).

people to move from the rental to the buyer market. The Harvard Study concluded that the proportion of low-income households in the population is growing.[100] When potential first-time home buyers cannot afford to buy a home, the demand for and cost of rental housing will increase sharply. In these circumstances, the very-low-income households will suffer the most, as they can least afford to pay the higher rents and will be forced to accept the most undesirable accomodations. The government must encourage moderate-income households to move from rental housing into their own homes and must also provide incentives and resources for the development of new multi-family rental properties.

The indirect subsidy provided by housing bonds may not be the most effective mechanism for addressing many aspects of the low-income housing problem. Perhaps tax-exempt housing programs should be considerably revised or even abolished. This conclusion, however, should be reached only after a thorough examination of the available economic and social data and a comprehensive review of the efficacy and efficiency of alternative programs. To date Congress has avoided this review.

The Tax Reform Act exemplifies the dramatic impact revenue policies may have on substantive policy. When, as the Harvard Study shows, homeownership rates have declined steadily since 1980 and "[r]ising rents have led to an increasing share of households paying 30, 40, or even 50 percent of their incomes for rents, if they can secure housing at all,"[101] the need to enhance and fund the nation's low-income housing stock warrants a more focused examination than that which occurred during the late summer and early fall of 1986. Typical of the partial analysis of housing policy undertaken by those concerned with fiscal policy is that the GAO Report was released approximately eighteen months after the enactment of the Tax Reform Act. Unfortunately for those concerned with the pending low-income housing crisis in the States, the lobbying efforts of interest groups far more powerful and better financed than those that support subsidized housing dominated and influenced the committee and legislative processes during the "hurly-burly" of the 1986 review of the Code.

As the Harvard Study recently concluded, "[t]here is no single housing problem in America, but a series of problems that confront

100. Apgar & Brown, *supra* note 1, at 1.
101. *Id.*

a wide range of household types."[102] Policy makers must therefore design programs that can systematically and rationally address the many facets of the current housing crisis. If raising revenue is Congress's ultimate concern, that goal might be far more easily attained in the housing area by abolishing the income tax deduction on conventional mortgages for primary and secondary or "vacation" homes that provides a significant tax break to those in the higher income brackets,[103] than by tinkering with tax-exempt financing programs for low- and moderate-income families and individuals. Regardless of one's ultimate goal, however, the housing crisis in America should be a national priority that demands a legislative response informed by a comprehensive analysis of all the issues, not just the piece-meal concerns of certain fiscal policy makers and interest groups.

102. *Id.* at 19.

103. *See generally* Sheppard, Our Lopsided Federal Housing Tax Policy Analyzed by National League of Cities and Price Waterhouse, 27 Tax Notes 233 (1985).